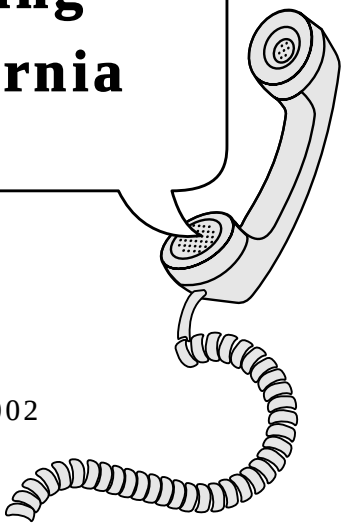
Frequently Asked Questions

Mortgage Loan Brokering in California



Revised
January 2002

Published by:

State of California
Department of Real Estate
Mortgage Lending Section

Frequently Asked Questions
Mortgage Loan Brokering in California

The purpose of this informational pamphlet is to provide answers to some of the most frequently asked questions regarding licensing and other related issues for those who are interested in some aspect of the mortgage business in California. Questions come from both licensees and non-licensees from other states and California expressing an interest in California licensing requirements to engage in mortgage activity. The following questions and answers are intended to answer many, but by no means all, of these inquiries from the standpoint of the Department of Real Estate requirements.

Q. As a mortgage broker in Kansas (or any other state), my plan is to move to California and pursue this same business. Does California issue mortgage broker licenses and is there any reciprocity in licensing with other states?

A. California does not issue a "mortgage broker" license. A majority of those engaged in mortgage loan brokering do so with a *real estate broker* license. To the surprise of some, the license that allows the listing and sale of real property (the traditional activities associated with a real estate broker license) is the same license that allows the solicitation of borrowers or lenders, the negotiation of loans secured by real property and the collection of payments on notes secured by real property. For further details concerning the definition of licensed activity, review Business and Professions Code Sections 10130 and 10131.

It should be noted there are other licenses that allow mortgage loan brokering under a limited set of circumstances, such as the California *finance license* and the *residential mortgage lending license*. For information about these licenses contact the California Department of Corporations. (See addresses at end of pamphlet.)

California does not have reciprocity with any other state as far as a real estate license is concerned. Information regarding obtaining either an individual or corporation real estate broker license is explained in a booklet titled *Instructions to License Applicants*. The booklet is available at any Department of Real Estate office, the locations of which are listed at the end of this pamphlet and on the DRE Web site **www.dre.ca.gov**.

Q. As a mortgage broker working outside of California, I occasionally have clients who are moving to California and have asked me to broker a loan for them to be secured by their new home. Although I am not licensed in California, can I broker a loan secured by California real estate? Does California have a rule that allows me to broker a small number of loans in California before I would have to be licensed?

A. No. To broker even one loan in California you need to be licensed here. However, California Real Estate Law does allow a California broker to share a commission with a broker from another state. Therefore, it may be possible to co-broker the loan with a licensed California broker.

Q. I am a licensed California real estate broker and I specialize in the sale of real property, primarily residential homes. I would like to branch out and engage in mortgage brokering. What additional licensing must be obtained?

A. As a licensed real estate broker, you may engage in mortgage brokering without any additional license. A real estate broker may engage in a variety of real estate related activities including residential home sales, mortgage brokerage, and property management, among others. You may, however, wish to consult with the Department of Housing and Urban Development to determine their rules regarding real estate sales and the arranging of FHA loans. Additionally, if you represent a buyer or seller in a real estate transaction, and will also be compensated for obtaining the loan for the buyer, Commissioner's Regulation 2904 requires you to disclose, to all parties in the transaction, the form, amount, and source of the compensation received or expected for the loan.

Q. Another broker told me that the kind and volume of mortgage brokerage activity I engage in makes me a "threshold" broker. What does that mean?

A. Determining whether a broker meets the "threshold" criteria takes a careful reading of Section 10232 of the Business and Professions Code. Generally, the criteria is met by brokers who arrange, sell, or service "private investor" or "private lender" loans, sometimes referred to as "hard money" loans. The "threshold" criteria is satisfied by negotiating 10 or more loans or sales of notes or real property sales contracts in any 12-month period in an aggregate amount of more than $1,000,000 (all of which were funded or purchased by private investors or small pension trusts).

A broker can also meet the "threshold" criteria by servicing loans on behalf of investors or on behalf of obligors. If the aggregate amount of

payments collected is $250,000 in any 12-month period, the "threshold" criteria has been met. Included in the $250,000 aggregate is any amount the broker collects on loan payoffs. Brokers who collect payments on behalf of obligors are typically those who collect payments from homeowners on a bi-weekly mortgage payment plan.

Within 30 days of meeting the "threshold" criteria, a broker is required to submit a Threshold Notification (RE 853) to the Department. The notification form is available at any DRE office or may be downloaded from the DRE Web site at www.dre.ca.gov.

Q. Once I've submitted a notification (RE 853) to the Department advising of my "threshold status," what happens next?

A. After receipt of the "threshold" notification, the Department sends the broker information and necessary documents for required quarterly and annual reporting to the Department and adds the broker to the "threshold" list. The Department then tracks and records each required report from the broker.

Q. What kind of reporting requirements are necessary if I satisfy the "threshold" criteria?

A. "Threshold" brokers make quarterly and annual reports to the Department on their trust fund bank accounts and an annual report on their business activities. Except for the annual trust fund report (which is done by a public accountant per instructions from the Department), the Department provides the necessary forms for the quarterly trust account and annual business activity reports. These are provided to the broker upon receipt of the "threshold" notification form.

Q. I am a broker who arranges loans for, and sells notes to, private investors and small pension trusts. May I also borrow personally from any of these investors?

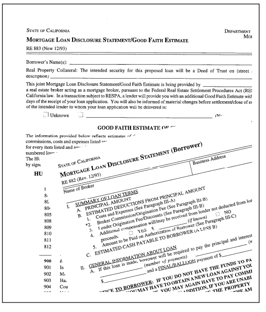
A. Yes. However, these "self-dealing" loans are highly scrutinized and require notice to DRE before the transaction is completed. Before a broker, or salesperson acting on behalf of a broker, solicits and accepts funds for the direct or indirect use or benefit of the broker, the broker must submit to DRE a true copy of the Lender/Purchaser Disclosure Statement (RE 851) prior to obtaining the signature of the investor/purchaser. The RE 851 must be accompanied by the broker's statement that the submittal is being made pursuant to Business and Professions Code Section 10231.2. While the broker need not wait for DRE's approval of the transaction, the Lender/Purchaser Disclosure Statement must be presented to the investor/lender not less than 24 hours prior to that person becoming obligated to make the loan or purchase the note. The Lender/Purchaser Disclosure Statement must also give a detailed explanation of the intended

use of the funds, including an explanation of the nature and extent of the benefits to be derived directly or indirectly by the broker. It is very important to understand that “self-dealing” is not permitted in multiple investor (fractionalized) transactions except under the limited circumstances set forth in Business and Professions Code Section 10229(d)(1).

Q. When engaged in mortgage loan brokering, are there any special trust fund record keeping requirements?

A. Yes. In addition to the trust fund record keeping requirements of the Business and Professions Code that apply to all real estate brokers, mortgage brokers must also maintain quarterly trust fund reconciliations of their trust account on special forms available from the Department. These forms are completed, maintained in the broker’s office, and made available upon request to a Department representative for review. The quarterly reconciliation forms, RE 855 and RE 856, can be downloaded from the DRE Web site **www.dre.ca.gov**.

Q. Are there specific disclosure statements that must be used by a real estate broker in the mortgage business?


STATE OF CALIFORNIA
MORTGAGE LOAN DISCLOSURE STATEMENT/GOOD FAITH ESTIMATE
RE 883 (New 12/93)
GOOD FAITH ESTIMATE
STATE OF CALIFORNIA
MORTGAGE LOAN DISCLOSURE STATEMENT (Borrower)
RE 882 (Rev. 12/93)

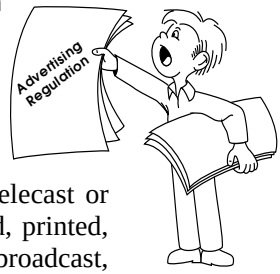
A. Every real estate broker who negotiates a loan to be secured directly or collaterally by a lien on real property shall, within three business days after receipt of a completed written loan application or before the borrower becomes obligated on the note, whichever is earlier, cause to be delivered to the borrower a statement in writing (borrower’s disclosure statement), containing all the salient features of the loan to be negotiated by the broker. The statement must be personally signed by the borrower and by the real estate broker negotiating the loan or by a real estate licensee acting for the broker in negotiating the loan. When so executed, an exact copy thereof shall be delivered to the borrower at the time of its execution.

A federal Good Faith Estimate (GFE) may also be required in a loan transaction under the Real Estate Settlement Procedures Act (RESPA). The GFE may contain some similar disclosures but it cannot, without modification pursuant to Business and Professions Code Section 10240(c), be a substitute for the disclosure statement required by state law. The state disclosure statement is called the Mortgage Loan Disclosure Statement (MLDS). If a GFE is necessary in the loan transaction, the Department has available a Mortgage Loan Disclosure Statement/Good Faith Estimate (MLDS/GFE). The MLDS/GFE satisfies the state disclosure requirement and the federal GFE requirement.

In addition to a disclosure statement for the borrower in a loan transaction, there are lender disclosure statements that a broker may be required to use. Unlike the MLDS or MLDS/GFE which must be provided to a borrower in virtually every loan transaction, the disclosure statement for a lender/investor is limited to private and small pension trust lenders/investors. Lenders/investors such as banks, savings and loan associations, credit unions, and a variety of others need not receive the lender/investor disclosure statement which is called the Lender/Purchaser Disclosure Statement (LPDS).

Every real estate broker, in making a solicitation to a private investor and in negotiating with that investor to make a loan secured by real property or to purchase a real property sales contract or a note secured by a deed of trust, is required to deliver to the investor solicited the applicable completed statement as early as practicable before he or she becomes obligated to purchase or make the loan. The statement shall be signed by the prospective lender or purchaser and by the real estate broker, or by a real estate salesperson licensed to the broker, on the broker's behalf. When so executed, an exact copy shall be given to the prospective lender or purchaser. The Department has available three versions of the LPDS, depending on the type of transaction. There are statements for loan origination, sale of an existing note and one for a collateralized loan. Please note that collateralized loans are not permitted in multi-lender transactions.

Q. Are there specific rules or laws that pertain to advertising by real estate brokers engaging in mortgage activity?



A. Yes. The law states, in part, that:

"No real estate licensee shall knowingly advertise, print, display, publish, distribute, telecast or broadcast, or cause or permit to be advertised, printed, displayed, published, distributed, televised or broadcast, in any manner any statement or representation with regard to the rates, terms, or conditions for making, purchasing or negotiating loans or real property sales contracts which is false, misleading or deceptive."

To assist licensees in complying with the law, Commissioner's Regulation 2848 sets forth sixteen (16) subsections of "don'ts" of mortgage loan advertising. A copy of this advertising regulation is available from the Mortgage Loan Section in Sacramento. The regulation is also contained in the *Real Estate Law* book available on the DRE Website **www.dre.ca.gov** or for purchase at any DRE office or by mail from the Sacramento Office.

Q. What about those who advertise from outside of California via the Internet?

A. Advertising real estate services on the Internet, including mortgage loan services, is considered solicitation of a California resident when read by a resident of California. Either the out-of-state advertiser on the Internet must be properly licensed in California or the ad must contain a disclaimer to the effect that the ad is not valid in California. The Department has prepared information regarding Internet advertising which is available from any Department district office and is partially reproduced here:

Internet Advertising

These guidelines have been prepared by the California Department of Real Estate to assist real estate brokers and businesses that are **not licensed in California** who are considering advertising real estate services on the Internet.

If you are not properly licensed in California, you may not solicit California residents. To do so would be considered conducting activity for which a real estate license is required. Because the Internet can be read by anyone in any location, advertising your services on the Internet would be considered soliciting a California resident when read by a resident of this state.

If you conduct activity which requires a California real estate license, but you are not a California licensee, you could be subject to administrative sanction such as a Desist and Refrain Order.

If you are now conducting, or plan to conduct, the above activity in California, you need to apply for a real estate broker license. To obtain information on becoming licensed in California, you may contact the Licensing Section of the California Department of Real Estate at 2201 Broadway, Sacramento, California 95818, Telephone 916-227-0931. Information is also available on the DRE Web site **www.dre.ca.gov**.

If you don't plan to become licensed in California, you should make sure your Internet advertising contains a disclaimer such as the following: "Notice: This offer is valid only in State 1, State 2..." (states wherein you are licensed or authorized to do business). If you are licensed in numerous states, you may want the disclaimer to read: "Notice: This offer is not valid in State 1, State 2..." (states in which you are not licensed or authorized to do business).

Q. Are there some advertising violations that are more often encountered than others?

A. Yes. Some of the more common advertising violations are:

- Using terms in a comparative or superlative degree to describe any

aspect of the business or any terms applicable to loans negotiated by the broker, without setting forth in the ad additional information to render the superlative or comparative terms unambiguous in the context in which they are used. For example, a broker who advertises "FAST LOANS" must also set forth in the ad how "fast is fast" (e.g. "most loans closed in 90 days from application"). A broker who advertises "LOW RATES" should also set forth in the ad what rates are available so that the term "LOW" is actually defined. It should be noted that the Department may require the broker to substantiate any claims made in an ad or require additional qualifiers in the ad to ensure the ad is not misleading to the public.

- Advertising a specific payment for a loan without including in the ad an equally prominent disclosure of the loan's interest rate, APR, principal amount, number, amount and period of payments scheduled to maturity and the balance due at maturity if not a fully amortized loan.
- Advertising an interest rate without disclosing whether the rate is for first mortgages, junior loans or both.
- Advertising a loan program with special qualifying restrictions or special requirements without setting forth those requirements or restrictions in the ad.
- Advertising an interest rate without an equally prominent disclosure of the APR. It should be noted that if a rate appears in an ad without an APR, a disclosure of "APR NOT CALCULATED" is **not** sufficient. An APR must be disclosed if a rate appears in the ad.

In addition to the above examples, which are based on specific subsections of the regulation, phrases and words used in advertising can be misleading in themselves. "No Cost" loans and "No Fee" loans are such words. All real property secured loans have certain inherent costs, such as title insurance, escrow, appraisal, recording fees, etc. These services are bought and paid for by the borrower in all loan transactions. In the cases where a broker arranges a premium priced loan where a lender rebate is used to pay for these services, the services are still performed and the costs incurred. The borrower pays the costs of the services via a higher interest rate than would be available if the borrower paid for the services out-of-pocket. In effect, the borrower finances the closing costs over the entire life of the loan. Although there may be no out-of-pocket costs to the borrower, clearly there are fees and costs involved, contrary to the claims in these ads.

Q. I understand something called the "multi-lender rule" was transferred from the California Department of Corporations to the Department of Real Estate. What is this and how may I as a mortgage broker be affected?

A. The Department of Corporations enforces the state securities laws which require that any security in an issuer transaction be qualified prior to sale with certain exemptions. Such an exemption was the "multi-lender rule" (Section 260.105.30) which permitted the sale of interests in notes secured by real property to not more than 10 persons as defined. This "rule" was legislatively transferred by Assembly Bill 754 (Kuykendall) to the Department of Real Estate as Section 10229 of the Business and Professions Code.

Any real estate broker (mortgage broker) involved in loan transactions secured by real property where the investors number 10 or less, but more than one, known as fractionalized notes, must notify the Department of Real Estate of the engagement in "multi-lender" activity. Any broker who arranges, sells or services such fractionalized notes must file a Multi-Lender Transaction Notice (**RE 860**) with the Department within 30 days of the first such transaction. Quarterly, CPA-prepared reports must be filed by any broker who acts as the servicing agent for such notes where the payments due during any period of three consecutive months exceeds $125,000, or the number of persons entitled to payments exceeds 120. The quarterly reports are in addition to the "threshold reports" previously discussed. Section 10229 is very detailed and should be carefully reviewed before becoming involved in multi-lender transactions.

Q. As a mortgage broker, can I collect fees from a borrower to cover certain costs in a loan transaction when a loan application is taken, such as a fee to cover my expenses in processing the application or fees for credit report and appraisal?

A. Fees that are collected by the broker from a borrower prior to the services being rendered are defined as "advance fees." To preclude the inappropriate use of such fees, a broker can only collect "advance fees" if the contract or agreement to do so has been submitted to and approved by the Department in advance of use. This agreement specifically tells a borrower how the "advance fees" are to be used by the broker. The broker must also maintain all "advance fees" in a trust fund bank account and they must be expended only on behalf of the borrower. In addition, whatever other materials the broker might use in collecting "advance fees" must also be submitted to the Department, prior to use, for review and approval.

Credit report and appraisal fees, although technically "advance fees" are not considered as such and may be collected without adhering to the

prescribed advance fee procedures. These fees are invariably passed to third parties performing the services. They must, however, be maintained in a trust fund bank account and expended appropriately. A broker may not profit from the collection of credit report and appraisal fees. If actual costs are less than collected, the excess must be refunded to the borrower.

Q. I am not licensed as a real estate broker or real estate salesperson and I am only going to assist private parties who wish to sell their notes (secured by real property) for cash to another party (investor), perhaps in another state. Is a real estate license required if I conduct this activity in California?

A. The activity described, so-called note brokering, requires a real estate license if performed in California. This includes the solicitation of California note owners, whether in person, by mail, telephone, or other means of communication. One of the definitions of a real estate broker is:

"...a person who, for a compensation or in expectation of a compensation, regardless of the form or time of payment, does or negotiates to do one or more of the following acts for another or others:

…(e) Sells or offers to sell, buys or offers to buy, or exchanges or offers to exchange a real property sales contract, or a promissory note secured directly or collaterally by a lien on real property or on a business opportunity, and performs services for the holders thereof."

There are companies engaged in the discounted purchase of certain mortgages, primarily those carried back by residential sellers and secured by the transferred real property. The companies hold seminars to recruit people to solicit and negotiate the sale of these mortgages. Seminar attendees are informed that they do not need a real estate license to engage in this activity. In California, this is wrong because the activity fits the definition quoted above.

Q. Is a real estate licensee in the mortgage business required to show any specific disclosure of his or her license status in an ad?

A. All California real estate licensees, when acting as such, must disclose licensure in advertising. For a broker engaged in mortgage loan activity, the following also applies:

"No real estate licensee shall place an advertisement disseminated primarily in this state for a loan unless there is disclosed within the printed text of that advertisement, or the oral text in the case of a radio or television advertisement, the license under which the loan would be made or arranged."

A real estate broker must include one of the following disclosures in any

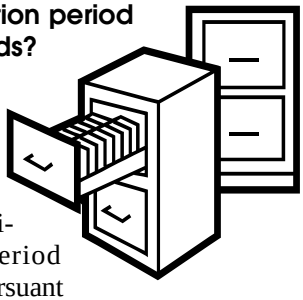
mortgage loan advertising:

"Real estate broker, California Department of Real Estate" or "California Department of Real Estate, real estate broker." The words "California" and "Department" may be abbreviated as "CA", "CAL" or "CALIF" and "DEPT."

In addition to the license and licensing department identifiers, mortgage brokers must include their 8 digit broker license identification number in the ad.

In the borrower and lender/purchaser disclosure statements (MLDS and LPDS), a broker must disclose the license identification number **and** the information telephone number established by the Department that a consumer can call to inquire about the license status of the broker.

Q. Has there been a change in the retention period that brokers are required to keep records?



A. The general rule is that brokers are required to keep records for a three-year period. However, pursuant to Business and Professions Code §10229(e)(1), the investor qualification statement required on a multi-lender loan has a four-year retention period requirement. Also, self-dealing statements, pursuant to Business and Professions Code §10231.2(b), must be retained for four years by the broker.

Real estate brokers are not only affected by laws and regulations enforced by the Department of Real Estate, but also many others at both the state and federal level. The foregoing questions and answers are based on the California Business and Professions Code and the Regulations of the Real Estate Commissioner. Real estate brokers should be familiar with the other laws affecting their business. In this regard, they may receive assistance from other enforcement agencies, private legal advisors, and/or professional trade organizations.

Office Locations

Department of Real Estate

2201 Broadway
P.O. Box 187000 (mailing address)
Sacramento, CA 95818-7000

(916) 227-0931 (General)
(916) 227-0770 (Mortgage Loan Section)
(916) 227-0772 (Publications)

2550 Mariposa Mall, Suite 3070
Fresno, CA 93721-2273
(559) 445-5009

320 W. 4th Street, Suite 350
Los Angeles, CA 90013-1105
(213) 620-2072

1515 Clay Street, Suite 702
Oakland, CA 94612-1402
(510) 622-2552

1350 Front Street, Suite 3064
San Diego, CA 92101-3687
(619) 525-4192

Department of Corporations

320 W. 4th Street, Suite 750
Los Angeles, CA 90013-2344
(213) 576-7500

1515 K Street, Suite 200
Sacramento, CA 95814-4052
(916) 445-7205

US Department of Housing and Urban Development (HUD) Regional Office

P.O. Box 36003
450 Golden Gate Avenue
San Francisco, CA 94102-3448
(415) 436-6550

Federal Trade Commission (FTC) Regional Offices

901 Market Street, #570
San Francisco, CA 94103
(415) 356-5270

10877 Wilshire Blvd., #700
Los Angeles, CA 90024
(310) 824-4343